Canby Telephone Association and Subsidiaries

Consolidated Financial Statements with Supplemental Information

Years Ended December 31, 2016 and 2015

Aldrich℠

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

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Years Ended December 31, 2016 and 2015

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Aldrich CPAs + Advisors LLP
680 Hawthorne Avenue SE, #140
Salem, Oregon 97301

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Canby Telephone Association and Subsidiaries
Canby, Oregon

We have audited the accompanying consolidated financial statements of Canby Telephone Association (an Oregon cooperative corporation) and Subsidiaries (the Association), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, changes in members' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Canby Telephone Association and Subsidiaries as of December 31, 2016 and 2015, and the results of their operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Report on Consolidating Information
Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The consolidating information in Schedules I-II are presented for the purposes of additional analysis of the consolidated financial statements rather than to present results of operations and cash flows of the individual companies, and it is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The consolidating financial information has been subject to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.

Aldrich CPAs + Advisors LLP

Salem, Oregon
April 3, 2017

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2016 and 2015

ASSETS	2016	2015
Current Assets:		
Cash and cash equivalents	$ 1,349,789	$ 3,903,895
Marketable securities	2,228,869	3,040,448
Accounts receivable	1,664,227	1,654,686
Inventory	1,152,050	915,211
Income taxes receivable	122,310	42,000
Prepaid expenses	519,208	547,737
Total Current Assets	7,036,453	10,103,977
Other Assets and Investments:		
Other assets	82,933	79,802
Investments	850,315	1,037,606
Deferred income taxes	-	609,297
Goodwill	640,748	3,974,375
Total Other Assets and Investments	1,573,996	5,701,080
Property, Plant, and Equipment:		
Property, plant, and equipment	68,281,437	61,838,801
Less accumulated depreciation	44,335,669	42,031,926
Property, Plant, and Equipment, net	23,945,768	19,806,875
	$ 32,556,217	$ 35,611,932

LIABILITIES AND MEMBERS' EQUITY	2016	2015
Current Liabilities:		
Accounts payable	$ 974,201	$ 622,466
Accrued expenses	779,306	838,003
Patronage capital payable	29,577	29,577
Income taxes payable	-	3,561
Customer deposits and advance billings	1,003,202	961,618
Total Current Liabilities	2,786,286	2,455,225
Long-Term Liabilities:		
Deferred income taxes	1,915	-
Deferred compensation	82,933	79,802
Other long-term liabilities	1,096,367	1,100,280
Total Long-Term Liabilities	1,181,215	1,180,082
Members' Equity:		
Memberships	47,401	47,401
Patronage capital	14,453,542	14,529,110
Accumulated earnings	14,447,031	17,948,296
Accumulated other comprehensive loss	(359,258)	(548,182)
Total Members' Equity	28,588,716	31,976,625
	$ 32,556,217	$ 35,611,932

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Operations

Years Ended December 31, 2016 and 2015

	2016	2015
Operating Revenues:		
Local network services	$ 2,359,771	$ 2,467,558
Network access services	6,915,541	7,327,150
Internet	3,532,527	3,148,161
Long distance	388,681	417,444
Video	2,064,536	1,858,050
Other non-regulated revenues	697,859	641,223
Miscellaneous operating	339,013	511,916
Total Operating Revenues	16,297,928	16,371,502
Operating Expenses:		
Plant specific	2,351,361	2,530,456
Plant nonspecific	1,104,701	1,135,190
Customer	1,588,776	1,606,644
Corporate	2,103,747	2,069,218
Depreciation and amortization	2,396,801	2,719,946
Operating income tax expense (benefit)	(33,851)	185,936
Other operating taxes	424,366	435,684
Internet	2,099,447	1,964,267
Long distance	338,464	471,400
Video	2,443,781	2,289,213
Other non-regulated expenses	1,003,735	809,297
Total Operating Expenses	15,821,328	16,217,251
Operating Margin	476,600	154,251
Other Income (Expense):		
Interest and investment income (loss)	(63,252)	153,627
Interest expense	-	(4,872)
Gain on sale of asset	87,901	-
Miscellaneous income (expense), net	(82,135)	(39,229)
Income tax benefit (expense)	14,375	(27,101)
Total Other Income (Expense), net	(43,111)	82,425
Net Margin Before Impairment of Goodwill and Elimination of Deferred Taxes	433,489	236,676
Impairment of Goodwill and Elimination of Deferred Taxes	3,974,375	-
Net Margin (Loss)	$ (3,540,886)	$ 236,676

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Comprehensive Income (Loss)

Years Ended December 31, 2016 and 2015

	2016	2015
Net Margin (Loss)	$ (3,540,886)	$ 236,676
Other Comprehensive Income (Loss):		
Unrealized loss on marketable securities	(41,400)	(196,498)
Reclassification for realized loss on the sale of marketable securities, net of tax	194,956	81,286
Change in unrecognized prior service costs and unrealized gain (loss) on post-retirement benefit plan	35,736	(90,726)
Deferred tax asset on unrealized gain (loss)	(368)	57,897
Total Other Comprehensive Income (Loss)	188,924	(148,041)
Total Comprehensive Income (Loss)	$ (3,351,962)	$ 88,635

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Changes in Members' Equity

Years Ended December 31, 2016 and 2015

	Member-ships	Patronage Capital	Accumulated Earnings	Accumulated Other Comprehensive Loss	Total
Balance, December 31, 2014	$ 47,401	$ 14,573,185	$ 17,696,784	$ (400,141)	$ 31,917,229
Net margin	-	-	236,676	-	236,676
Paid to estates, net of discounts	-	(44,075)	14,836	-	(29,239)
Unrealized holding loss on marketable securities	-	-	-	(57,315)	(57,315)
Change in unrecognized transition obligation and unrealized loss on post-retirement benefit plan	-	-	-	(90,726)	(90,726)
Balance, December 31, 2015	47,401	14,529,110	17,948,296	(548,182)	31,976,625
Net margin (loss)	-	87,817	(3,628,703)	-	(3,540,886)
Paid to estates, net of discounts	-	(54,806)	18,824	-	(35,982)
Unrealized holding gain on marketable securities	-	-	-	153,188	153,188
Change in unrecognized transition obligation and unrealized gain on post-retirement benefit plan	-	-	-	35,736	35,736
Other adjustments	-	(108,579)	108,614	-	35
Balance, December 31, 2016	$ 47,401	$ 14,453,542	$ 14,447,031	$ (359,258)	$ 28,588,716

See accompanying notes to consolidated financial statements.

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidated Statements of Cash Flows

Years Ended December 31, 2016 and 2015

	2016	2015
Cash Flows from Operating Activities:		
Net margin (loss)	$ (3,540,886)	$ 236,676
Adjustments to reconcile net margin (loss) to net cash provided by operating activities:		
Impairment of goodwill and elimination of deferred taxes	3,974,375	-
Gain on sale of assets	(87,901)	-
Depreciation and amortization	2,396,801	2,719,946
Non-regulated depreciation	524,180	499,667
Loss on sale of investments and marketable securities	194,746	80,347
Change in deferred taxes	(2,947)	137,666
Changes in assets and liabilities:		
Accounts receivable	(53,528)	68,809
Inventory	(236,839)	(132,774)
Prepaid expenses	28,529	(27,967)
Accounts payable	395,533	(126,917)
Accrued expenses	(49,424)	301,407
Income taxes	(83,871)	44,782
Other long-term liabilities	22,738	(14,668)
Customer deposits and advance billings	41,584	16,507
Deferred compensation	3,131	(824)
Net Cash Provided by Operating Activities	3,526,221	3,802,657
Cash Flows from Investing Activities:		
Capital expenditures	(7,059,874)	(3,792,673)
Purchase of investments and marketable securities	(1,966,858)	(2,256,399)
Proceeds from investments and marketable securities	2,985,483	2,112,134
Change in other assets	(3,131)	1,129
Net Cash Used by Investing Activities	$ (6,044,380)	$ (3,935,809)

See accompanying notes to consolidated financial statements.

		2016		2015
Cash Flows from Financing Activities:				
Principal payments on long-term debt	$	-	$	(189,625)
Payments to estates, net		(35,947)		(29,239)
Patronage capital paid, net		-		(22)
Net Cash Used by Financing Activities		(35,947)		(218,886)
Net Decrease in Cash and Cash Equivalents		(2,554,106)		(352,038)
Cash and Cash Equivalents, beginning		3,903,895		4,255,933
Cash and Cash Equivalents, ending	$	1,349,789	$	3,903,895
Cash Paid During the Year for Interest	$	-	$	5,167
Cash Paid During the Year for Taxes	$	40,897	$	70,099

See accompanying notes to consolidated financial statements.

Note 1 - Organization and Summary of Significant Accounting Policies

Organization

Canby Telephone Association (CTA or the Association) is an Oregon cooperative corporation providing telecommunications, broadband, and entertainment services within and around the cities of Canby and Mt. Angel, Oregon. The Association is now doing business under the name DirectLink.

DirectLink of Oregon, Inc. (DLO) is a wholly-owned subsidiary of the Association. DLO activity is limited to nonregulated activities including the lease of fiber and office space in the general vicinity of Canby, Oregon.

Mt. Angel Telephone Company (MATC) is an Oregon corporation that provided telecommunications and broadband services within and around the city of Mt. Angel, Oregon. MATC assets and liabilities were transferred to the Association effective December 31, 2016 and operations ceased at that time. It is the intent of the Association to dissolve MATC in 2017.

Basis of Consolidation

The consolidated financial statements of the Association include the accounts of the Association and its wholly-owned subsidiaries, DLO and MATC. All material intercompany transactions and balances have been eliminated in consolidation.

Basis of Accounting

The Association's financial statements are prepared on the accrual basis of accounting in conformity with the accounting principles generally accepted in the United States of America applicable to regulated enterprises.

Regulation

The Association is subject to limited regulation by the Public Utility Commission of Oregon (PUC) and the Federal Communications Commission (FCC). The Association maintains its accounting records in accordance with the Uniform System of Accounts, as prescribed by the FCC, and adopted by the PUC. As a result, the Association's application of accounting principles generally accepted in the United States of America differs in certain respects from the application by non-regulated entities. Such differences primarily concern the time at which certain items enter into the determination of net margin.

Regulatory and legislative actions, as well as future regulations, could have a significant impact on the Association's future operations and financial condition. See Note 1, National Broadband Plan and FCC Order.

Estimates

The Association uses estimates and assumptions in preparing consolidated financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses. Actual results could differ from those estimates.

Comprehensive Income

The Association reports comprehensive income. The purpose of reporting comprehensive income is to report all changes in members' equity of an enterprise that result from recognized transactions and other economic events of the period other than transactions with members in their capacity as members.

Income Tax

The Association has been granted an exemption from Federal income taxes, except for "unrelated" business income, under Section 501(c)(12) of the Internal Revenue Code. The Association is also exempt from state income taxes. However, in any year for which greater than 15% of gross revenue is derived from nonmember services, the Association becomes a taxable cooperative. The Association was exempt from income taxes in 2016 and 2015. Federal and state taxes payable by taxable cooperatives are computed differently from taxes payable by other corporations, primarily because cooperatives are allowed to deduct margins allocated or paid to patrons within 8 ½ months after the end of each taxable year. DLO is a taxable corporation and files a separate tax return.

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Income Tax, continued
MATC is a taxable corporation and will file a separate return for 2016 but will share in apportionment of the Federal tax bracket. Upon the dissolution of the Company a final return will be filed.

Income taxes are provided for the tax effects of transactions reported in the consolidated financial statements and consist of taxes currently due and deferred income taxes. Deferred taxes represent the future tax return consequences of differences between the financial statement and the tax basis of assets and liabilities, which will either be taxable or deductible when the related assets or liabilities are recorded or settled. Income tax expense is the tax payable or refundable for the period, plus or minus the change in deferred tax assets and liabilities during the period.

The Association follows accounting standards generally accepted in the United States of America related to the recognition of uncertain tax positions. The Association recognizes accrued interest and penalties associated with uncertain tax positions as part of the income tax provision, when applicable. There were no amounts accrued in the financial statements related to uncertain tax positions.

Revenue Recognition
The Association recognizes revenues when earned regardless of the period in which they are billed.

Monthly service fees derived from local telephone, flat rate toll (long distance), broadband and video services are billed in advance. Advance billings are recorded as a liability and subsequently transferred to income in the period earned. Access charges (see Note 1, Network Access Revenue), long-distance and other revenues based on usage are billed in arrears.

Cash and Cash Equivalents
The Association considers all highly liquid investment securities with a maturity of 3 months or less to be cash equivalents. The Association maintains its cash in bank deposit accounts that are insured by the Federal Deposit Insurance Corporation (FDIC) up to a limit of $250,000 per depositor per bank. At December 31, 2016, the Association had $883,215 in uninsured cash equivalents ($3,097,150 in 2015).

The Association has not experienced any losses in its bank deposit accounts and believes it is not exposed to any significant credit risk on cash.

Marketable Securities
The Association has classified all marketable securities as available for sale. These investments are stated at fair value in the consolidated financial statements with accumulated unrealized gains and losses reported as a separate component of members' equity.

Accounts Receivable
The Association extends credit to its customers. An allowance for doubtful accounts is considered, based upon management's review of the year-end accounts receivable aging and past credit and collections history. Receivables are written off when the Association determines an account is uncollectible. Past due status is determined based on the age of the past due account. No allowance for doubtful accounts was recorded at December 31, 2016 and 2015.

Fair Value of Financial Instruments
The Association's financial instruments, none of which are held for trading purposes, include cash and cash equivalents, marketable securities, receivables, and accounts payable. The Association estimates that the fair value of all of these non-derivative financial instruments at December 31, 2016 and 2015 does not differ materially from the aggregate carrying value of its financial instruments recorded in the accompanying consolidated balance sheets.

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Inventory
Inventory held for resale and telecommunication materials and supplies are stated at the lower of average cost or market. Cost is determined principally by the average cost method.

Goodwill
The Association recorded goodwill from the acquisition of MATC in 2008. Goodwill was evaluated for impairment and adjusted accordingly on an annual basis. As described in Note 12 the Association has recognized an impairment of goodwill during the year ended December 31, 2016.

The Association has elected the accounting alternative available to private companies related to goodwill and has elected to amortize goodwill on the straight-line method over a 10 year period beginning in 2017. Goodwill will be evaluated for impairment if an event occurs or circumstances change that indicate the value of the Association may be below its carrying amounts.

Investments
Investments in which the Association holds a 20%-50% interest are accounted for on the equity method. Investments accounted for on the equity method are recorded at cost and adjusted for the Association's share of income or loss. Investments in which the Association holds less than a 20% interest are recorded at cost and income is recorded when dividends are received.

Property, Plant, and Equipment
Telecommunications plant in service and under construction is stated at cost, including estimated overhead expense. Depreciation is calculated on a straight-line basis over the estimated life of the classes of buildings and equipment in accordance with rates consistent with industry standards. Depreciation rates range from 2% to 33.3%. Costs of plant retired are eliminated from telecommunications plant accounts and such costs plus removal expenses, less salvage, are charged to accumulated depreciation in accordance with industry practice.

Non-regulated equipment in service and under construction and DLO property and equipment are stated at cost. Depreciation is calculated on a straight-line basis over the estimated life of the classes of equipment. Depreciation rates range from 2% to 33.3%. Maintenance, repairs, and replacements are charged to expense as incurred. When property or equipment is sold or otherwise disposed of, the asset account and the related accumulated depreciation accounts are relieved, and any gain or loss is included in operations.

Patronage Allocation
Patronage capital is derived from margins retained from operations and refunds of federal excise taxes, both of which are allocated to the accounts of individual patrons and are subject to retirement at the discretion of the Board of Directors. Estate payouts are paid at a discounted rate of 5% per year up to 20 years and any amount over 20 years will be paid out at 100%.

Nonpatronage income, net of expenses, is recorded to accumulated earnings. Amounts included in accumulated earnings are not subject to allocation to the accounts of individual members. Losses sustained by the Association may be allocated to the accounts of individual patrons or offset to accumulated earnings at the discretion of the Board of Directors in accordance with the Association's bylaws.

Network Access Revenues
Network access revenue is received under a system of access charges. Access charges represent a methodology by which local telephone companies, including the Association, charge the long-distance carrier for access and interconnection to local facilities. The Association has elected to file access tariffs through the National Exchange Carriers Association (NECA) and directly with the PUC for these charges. These access tariffs are subject to approval by the FCC for interstate charges and the PUC for intrastate charges.

Note 1 - Organization and Summary of Significant Accounting Policies, continued

Network Access Revenues, continued
When network access revenues have been received pursuant to the settlement and access agreements above, they are then either placed into a common pooling arrangement with other exchange carriers for redistribution or kept by the Association. The redistributions are made according to formulas established by the governing boards of the pools and are generally based upon expenses incurred and investments maintained.

CTA and MATC participate in various pooling arrangements with NECA.

Settlement, access, and pool distribution revenues are recorded when the amounts become determinable. Related expenses are recorded when incurred. Subsequent true-ups and retroactive adjustments, which are generally allowed for a period of 24 months, are recorded in the year in which such adjustments become determinable, based upon studies prepared by outside consultants.

In 2016, CTA and MATC received $5,437,793 ($5,584,424 in 2015) in interstate access revenues administered through the NECA Pools.

CTA and MATC receive funding from the Oregon Universal Service Fund (OUSF). These support revenues are included in the network access revenues in the accompanying consolidated financial statements. In 2016, CTA and MATC recognized $821,983 from the OUSF ($975,748 in 2015). Funding levels for the Oregon Universal Service Fund were determined in accordance with PUC Order 13-162. In March 2016, the PUC issued order 16-093 related to OUSF. The order is for a 5 year term beginning January 1, 2017 and calls for annual reductions to the OUSF that will result in an overall reduction of not less than 15.2% over the 5 year term for rural companies. In addition rural companies will be subject to a re-allocation process over the term of the order but no company can have its support reduced by more than 20% over this period as a result of this process. The full impact of the order cannot be determined at this time.

National Broadband Plan and FCC Order
In 2010, the FCC issued the National Broadband Plan which outlined a long-term plan to increase broadband penetration and services throughout the United States of America.

In 2011, as an initial response to the plan, the FCC approved Report and Order 11-161 (the Order), that began the process of reforming the universal service and Intercarrier Compensation (ICC) systems and adopts support for broadband-capable networks as an express universal service principle. The Order further created the Connect America Fund (CAF) which will ultimately replace all existing high-cost support mechanisms and help facilitate ICC reforms.

The key provisions of the Order included capping the federal universal service fund (USF), placing limitations on capital and operating expenditures (subsequently eliminated in 2014 by an Order for Reconsideration issued by the FCC), establishing local rate benchmarks, capping monthly USF at $250 per line, 5% annual reduction of the frozen 2011 interstate switched access revenue requirement, the phase-out of local switching support to be replaced by the CAF to recover costs of switching services, a 9 year transition from the previous ICC system to bill and keep, and adoption of the Access Recovery Charge (ARC) to mitigate impacts of reduced ICC revenues. Implementation of this transition began July 1, 2012.

In 2016, the FCC issued Order 16-33, which provided the option for a voluntary election by rate-of-return carriers to receive model-based support under the Alternative Connect America Cost Model (A-CAM). On November 1, 2016, the Association did not elect to receive model based support under A-CAM. Carriers not electing A-CAM will continue to receive support based on their costs, however these legacy support mechanisms will be modified by Order 16-33.

Note 1 - Organization and Summary of Significant Accounting Policies, continued

National Broadband Plan and FCC Order, continued
The main changes for carriers remaining on legacy support are as follows:

- Interstate Common Line Support (ICLS) will be transitioned to the CAF – Broadband Line Support (CAF-BLS), which will now provide support for voice and voice – data lines, as well as broadband only lines. Additionally, the funding for overall high cost support will be limited to $2 billion.
- The prescribed rate of return will be reduced by 0.25% annually starting July 1, 2016, effectively reducing the rate of return from 11.25% to 9.75% as of July 2021.
- Carriers will have broadband deployment obligations based on their current availability of 10/1 mbps broadband service in applicable study areas.
- Support will be phased out in census blocks if 85% or more of the locations in the census block are serviced by unsubsidized competitors offering 10/1 mbps broadband. Lost support will be phased out over 3 to 6 years depending on the severity of lost support.
- Limits capital and operating expenditures on a prospective basis as outlined in the Order.

The Association continues to monitor various effects and requirements of the Orders noted above. As of December 31, 2016 the Association is not subject to the $250 per line support cap. Furthermore, for the period ended December 31, 2016 the impacts to the Association related to the 5% annual decline in switched access revenues, and the .25% reduction of the prescribed rate of return have not been significant.

The overall reform process will continue to take place in phases and will take several more years to implement. Furthermore, it is anticipated that the FCC will continue to issue Further Notices of Proposed Rulemaking and/or Orders for Reconsideration and continue to seek comments on various items. As a result, the ultimate outcome of these proceedings and their impact is uncertain at this time.

Reclassification
The presentation of certain prior year information has been reclassified to conform to the presentation in the 2015 consolidated financial statements. Such reclassifications have no effect on members' equity or net margin.

Subsequent Events
The Association has evaluated subsequent events through April 3, 2017, which is the date the consolidated financial statements were available to be issued.

Note 2 - Marketable Securities

As mentioned in Note 1, at December 31, 2016 and 2015, all marketable securities have been categorized as available for sale and are stated at fair value in the consolidated financial statements, with unrealized gains and losses included in accumulated other comprehensive loss as a separate component of members' equity.

The Association has adopted a hierarchical disclosure framework, which among other matters, requires enhanced disclosure about investments that are measured and reported at fair value. This framework prioritizes and ranks the level of market price observability used in measuring investments at fair value. The Association's marketable securities are measured and reported at fair value on a recurring basis based on quoted prices available in active markets for identical investments as of the reporting date (Classification Level 1). There have been no changes to the methodologies used at December 31, 2016 and 2015.

Note 2 - Marketable Securities, continued

At December 31, the Association's securities consisted of the following:

	2016	2015
Fair Value:		
Mutual funds	$ 2,228,869	$ 3,040,448
Cost	2,223,930	3,250,008
Gross unrealized holding gains (losses)	$ 4,939	$ (209,560)

Gross unrealized holding gains of $4,939 (unrealized holding loss of $209,560 in 2015) are included in accumulated other comprehensive loss, net of deferred taxes of $1,814 in 2016 ($59,294 in 2015). Realized gains and losses are determined on the basis of specific identification. Proceeds from the sale of marketable securities for the year ended December 31, 2016 were $2,797,982 ($2,109,710 in 2015) resulting in a gross realized loss of $194,956 for the year ended December 31, 2016 ($81,286 for the year ended December 31, 2015).

Note 3 - Inventory

Inventory consists of the following:

	2016	2015
Telecommunications	$ 1,120,897	$ 877,678
Non-regulated	31,153	37,533
	$ 1,152,050	$ 915,211

Note 4 - Investments

Investments consist of the following:

	2016	2015
RTFC subordinated certificates and allocated capital credits	$ 324,675	$ 324,675
CHR Solutions Inc.	302,677	302,677
ANPI Holding, Inc.	60,808	248,309
Consolidated Business Services, LLC	85,000	85,000
CoBank, equity investment and patronage allocations	45,168	44,958
Other investments	31,987	31,987
	$ 850,315	$ 1,037,606

Shares of RTFC subordinated certificates are purchased as a condition of obtaining long-term financing from the RTFC. Holders of subordinated certificates are entitled to patronage dividends.

CoBank is a cooperative bank. Borrowers are required to invest a minimum of $1,000 or 2% of their loan, whichever is less. Patronage dividends are paid annually in cash and in stock at the discretion of the board of directors of CoBank.

During 2016, the controlling interest of ANPI Holdings, Inc. was sold and they began the process of redeeming the preferred stock. As of December 31, 2016, 75% of the preferred stock has been redeemed and the Association received proceeds of $187,501 from their investment in preferred stock. The remaining preferred stock in ANPI Holdings, Inc. is expected to be redeemed during 2017.

Effective September 1, 2012 the Association, along with two other telecommunication companies, formed Consolidated Business Services, LLC to consolidate various administrative functions. Services currently being provided to the companies include accounting, regulatory reporting, management services and human resources.

Note 4 - Investments, continued

All three companies have a one-third ownership interest and any net income or loss will be distributed evenly to each company. The Association accounts for the investment using the equity method of accounting whereby the investment is recorded at cost and adjusted for the Association's share of income or loss. For the years ended December 31, 2016 and 2015, the Association did not contribute any additional amounts and no income or loss was allocated.

Note 5 - Other Assets

Other assets consist of the following at December 31:

	2016	2015
Deferred compensation assets	$ 82,933	$ 79,802

Deferred compensation assets represent amounts held in Trust to be used for payment of deferred credits.

Note 6 - Property, Plant, and Equipment

Listed below are the major classes of property, plant, and equipment in service at December 31:

	2016	2015
Cable and wire facilities	$ 34,407,363	$ 30,221,900
Central office	16,939,214	15,675,566
Land, buildings, and support	9,597,880	9,505,576
Amortizable assets	55,890	55,890
Non-regulated	6,757,468	6,142,945
Under construction	523,622	236,924
	$ 68,281,437	$ 61,838,801

Note 7 - Employee Benefit Plans

The Association participates in a contributory, multi-employer, defined-contribution saving plan administered by NTCA, which covers all full-time eligible employees. Employees are not required to make contributions to participate in the plan. Effective May 1, 2013 the plan was amended to allow employer contribution of 4% plus a dollar for dollar match of up to 4%. Additionally, it includes a 4% supplemental employer contribution for employees hired prior to May 1, 2013. The employer also reimburses the participant for any plan fees. Employer contributions to the plan were $451,303 in 2016 ($449,121 in 2015).

Note 8 - Income Taxes

The following is a summary of the significant components of the deferred tax assets and liabilities as of December 31, 2015:

	2016	2015
Long-term deferred income tax asset (liability):		
Accrual to cash adjustment	$ -	$ (31,000)
Unrealized (gain) loss on marketable securities	(1,915)	59,257
Property, plant, equipment and goodwill	-	548,000
Post-retirement health benefits accrual	-	33,000
Noncurrent deferred income tax asset (liability)	$ (1,915)	$ 609,297

Note 8 - Income Taxes, continued

Upon the transfer of the assets and liabilities of MATC to the Association, the net deferred tax assets at the time of transfer of approximately $600,000 were eliminated, as it is not expected these items will provide a future tax benefit to the Association.

Income tax expense (benefit) consists of the following:

	2016	2015
Operating:		
Deferred provision	$ -	$ 134,700
Current payable	7,651	59,440
Benefit of net operating loss carryback	(40,035)	-
Over accrual	(1,467)	(8,204)
Operating income tax expense (benefit)	$ (33,851)	$ 185,936
Nonoperating:		
Current (asset) payable	$ (10,150)	$ 40,760
Over accrual	(4,225)	(13,659)
Nonoperating income tax expense (benefit)	$ (14,375)	$ 27,101

The provision for income taxes differs from the amount computed by applying the current statutory federal and state income tax rates to earnings before income taxes due to the effects of state taxes (net of federal benefit), nondeductible items, net operating loss deductions, prior year over or under accruals, the use of accelerated depreciation for income tax purposes and the patronage deduction allowed for margins allocated to patrons.

Note 9 - Other Long-Term Liabilities

The Association sponsors a post-retirement benefit plan (the Plan) that provides medical and dental benefits for eligible retired employees and their spouses. The liability for such benefits is unfunded.

At December 31, 2011, the Association amended the Plan to freeze plan benefits and cover only current retirees and those who had accepted an early retirement offer in 2012.

The following table presents the estimated status of the Plan at December 31 based on the valuation as of December 31:

Obligations and Funded Status:	2016	2015
Accumulated postretirement benefit obligation:		
Retired plan participants	$ 887,267	$ 897,665
Accumulated postretirement benefit obligation	887,267	897,665
Fair value of plan assets	-	-
Net unfunded status of the Plan	887,267	897,665
Amounts Recognized in Accumulated Other Comprehensive Income:		
Net actuarial loss	(290,040)	(303,000)
Unrecognized prior service cost and unrealized losses	(290,040)	(303,000)
Accrued Postretirement Benefit Expense	$ 597,227	$ 594,665
Postretirement Expenses Includes the Following Components:		
Interest on accumulated postretirement benefit obligation	$ 39,000	$ 39,174

Note 9 - Other Long-Term Liabilities, continued

Changes in Plan Assets and Benefit Obligation Recognized in Other Comprehensive Income:				
Net actuarial loss		-		(8,778)
Amortization of loss		12,960		12,969
		12,960		4,191
Total recognized in net periodic benefit cost and other comprehensive income	$	51,960	$	43,365
Benefit Payments	$	49,398	$	50,690

Assumptions
For measurement purposes, a 7% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2016 (7% in 2015). The rate was assumed to decrease gradually to 5% at 2017 and remain at that level thereafter. The weighted average discount rate used in determining the accumulated postretirement benefit obligation was 4.5% in 2016 and 2015.

Cash Flows
The Association does not expect to contribute to its post-retirement benefit plan in 2017.

Expected Post-Retirement Benefit Payments

2017	$	54,879
2018		57,623
2019		60,504
2020		63,529
2021		66,706
Years 2022 - 2026		387,021

The Association sponsors a non-qualified defined benefit, post-retirement benefit plan which provides certain health care benefits for retired employees and their respective spouses until the date of the retired employee's death. Benefits are based on years of service and the employee's average compensation for the five highest compensated years of employment.

The annual measurement date is December 31 for the post-retirement benefit plan. The following tables provide information about changes in the benefit obligation and plan assets and the funded status of the Association's post-retirement benefit plan:

Obligations and Funded Status

		2016		2015
Benefit obligation at December 31	$	100,000	$	94,000
Fair value of plan assets at December 31		-		-
Net unfunded status of the plan	$	(100,000)	$	(94,000)
Benefit payments	$	(9,085)	$	(12,620)
Long-term benefit obligation	$	(100,000)	$	(94,000)
Other post-employment obligations		-		-
		(100,000)		(94,000)
Less current portion		9,085		9,085
	$	(90,915)	$	(84,915)

Note 9 - Other Long-Term Liabilities, continued

Assumptions
Weighted average assumptions used in the accounting for the Association's postretirement benefit plan were:

	2016	2015
Weighted-average assumptions used to determine benefit obligations at December 31:	4.5%	5.75%
Weighted average assumptions used to determine net periodic benefit cost for years ended December 31:	4.5%	5.75%

Cash Flows
The Association does not expect to contribute to its post-retirement benefit plan in 2017.

Expected Post-retirement Benefit Payments

2017	$ 9,085
2018	9,085
2019	9,085
2020	9,085
2021	9,085
Years 2022 - 2026	45,420

In 2015 the Association approved providing post-retirement medical benefits to employees who began their employment prior to December 31, 1990 and who have worked for the Association for an uninterrupted period of not less than 30 years and subsequently retire prior to reaching age 65. The Association will pay the health insurance premiums for these retirees until the earlier of age 65 or when they become eligible to receive Medicare benefits. The cost of providing these benefits is accrued over the period of active employment. At December 31, 2016, the amount accrued for this post-retirement benefit is $109,100 ($117,000 at December 31, 2015) and is unfunded. During 2015, adoption of the plan resulted in $113,900 being recognized in accumulated other comprehensive income at that time related to the past service of employees covered by the benefit. This past service cost will be amortized out of accumulated other comprehensive income over the average remaining service life of covered employees. Amortization of $22,776 was recognized in 2016 ($18,983 in 2015) and the remaining accumulated other comprehensive income at December 31, 2016 is $72,141 ($94,917 at December 31, 2015).

Note 10 - Related Party

The Association entered into an agreement with Consolidated Business Services, LLC (CBS, LLC) in 2012 (Note 4) whereby CBS, LLC will provide accounting, regulatory reporting, management services, and human resource services for the Association. CBS, LLC provided services to the Association in the amount of $415,093 in 2016 ($668,827 in 2015). At December 31, 2016, there is $56,545 payable to CBS, LLC for labor and expenses ($63,694 was payable to CBS, LLC at December 31, 2015).

Note 11 - Operating Leases

The Association leases substantially all of its copiers and printers under various operating leases with five year or month-to-month terms. In addition, the Association leases various vehicles under 5 year terms. Total lease expense under all operating leases for the years ended December 31, 2016 and 2015 was $53,677 and $21,843, respectively.

Note 11 - Operating Leases, continued

Minimum future amounts due under these leases as of December 31, 2016 are as follows:

2017	$	65,639
2018		65,639
2019		65,639
2020		44,351
2021		12,681

Note 12 - Goodwill

As a result of the transfer of the assets and liabilities of MATC to the Association on December 31, 2016 a new valuation of MATC was obtained. The Association has recognized an impairment loss of $3,333,627 for the year ended December 31, 2016 resulting from the new valuation.

The remaining goodwill of $640,748 will be amortized on a straight-line basis over a 10 year period.

SUPPLEMENTAL INFORMATION

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidating Statements of Operations

Year Ended December 31, 2016 — Schedule I

	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Operating Revenues:					
Local network services	$ 291,702	$ -	$ 2,068,069	$ -	$ 2,359,771
Network access services	1,242,042	-	5,673,499	-	6,915,541
Internet	449,016	-	3,083,511	-	3,532,527
Long distance	32,675	-	356,006	-	388,681
Video	5,823	-	2,058,713	-	2,064,536
Other non-regulated revenues	63,210	-	716,246	(81,597)	697,859
Miscellaneous operating	58,817	73,903	221,792	(15,499)	339,013
Total Operating Revenues	2,143,285	73,903	14,177,836	(97,096)	16,297,928
Operating Expenses:					
Plant specific	342,009	-	2,024,851	(15,499)	2,351,361
Plant nonspecific	202,350	-	902,351	-	1,104,701
Customer	297,356	-	1,291,420	-	1,588,776
Corporate	250,761	57,363	1,795,623	-	2,103,747
Depreciation and amortization	162,014	17,423	2,217,364	-	2,396,801
Operating income tax expense (benefit)	(42,880)	1,679	7,350	-	(33,851)
Other operating taxes	45,138	6,391	372,837	-	424,366
Internet	306,159	-	1,874,885	(81,597)	2,099,447
Long distance	42,724	-	295,740	-	338,464
Video	5,085	-	2,438,696	-	2,443,781
Other non-regulated expenses	134,833	-	868,902	-	1,003,735
Total Operating Expenses	1,745,549	82,856	14,090,019	(97,096)	15,821,328
Operating Margin (Loss)	397,736	(8,953)	87,817	-	476,600
Other Income (Expense):					
Interest and investment income (loss)	(2,108)	(33,192)	2,048	(30,000)	(63,252)
Interest expense	(30,000)	-	-	30,000	-
Gain on sale of assets	87,901	-	-	-	87,901
Miscellaneous income (expense), net	(7,206)	86	(75,015)	-	(82,135)
Income tax expense	-	14,375	-	-	14,375
Income from subsidiaries	-	-	418,639	(418,639)	-
Total Other Income (Expense), net	48,587	(18,731)	345,672	(418,639)	(43,111)
Net Margin (Loss) Before Impairment of Goodwill and Eliminatio of Deferred Taxes	446,323	(27,684)	433,489	(418,639)	433,489
Impairment of Goodwill and Elimination of Deferred Taxes	-	-	3,974,375	-	3,974,375
Net Margin (Loss)	$ 446,323	$ (27,684)	$ (3,540,886)	$ (418,639)	$ (3,540,886)

CANBY TELEPHONE ASSOCIATION and SUBSIDIARIES

Consolidating Statements of Cash Flows

Year Ended December 31, 2016 — Schedule II

	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Cash Flows from Operating Activities:					
Net margin (loss)	$ 446,323	$ (27,684)	$ (3,540,886)	$ (418,639)	$ (3,540,886)
Adjustments to reconcile net margin (loss) to net cash provided (used) by operating activities:					
Impairment of goodwill and elimination of deferred taxes	-	-	3,974,375	-	3,974,375
Gain on sale of assets	(87,901)	-	-	-	(87,901)
Depreciation and amortization	162,014	17,423	2,217,364	-	2,396,801
Non-regulated depreciation	1,907	-	522,273	-	524,180
Net income from subsidiaries	-	-	(418,639)	418,639	-
Loss on sale of investments and marketable securities	6,083	135,241	53,422	-	194,746
Change in deferred taxes	(2,947)	-	-	-	(2,947)
Changes in assets and liabilities:					
Accounts receivable	(65)	(395,734)	27,721	314,550	(53,528)
Inventory	(278)	-	(236,561)	-	(236,839)
Income taxes	(37,630)	(37,100)	(9,141)	-	(83,871)
Prepaid expenses	11,970	(87)	16,646	-	28,529
Accounts payable	(63,438)	(24)	773,545	(314,550)	395,533
Accrued expenses	722	-	(50,146)	-	(49,424)
Other long-term liabilities	6,000	-	16,738	-	22,738
Customer deposits and advance billings	1,435	-	40,149	-	41,584
Deferred compensation	-	-	3,131	-	3,131
Net Cash Provided (Used) by Operating Activities	444,195	(307,965)	3,389,991	-	3,526,221
Cash Flows from Investing Activities:					
Capital expenditures	(192,618)	(6,000)	(6,861,256)	-	(7,059,874)
Cash transfer	(1,020,930)	-	1,020,930	-	-
Purchase of investments and marketable securities	(70,761)	(1,353,717)	(542,380)	-	(1,966,858)
Proceeds from investments and marketable securities	68,213	1,315,837	1,601,433	-	2,985,483
Change in other assets	-	-	(3,131)	-	(3,131)
Net Cash Used by Investing Activities	$ (1,216,096)	$ (43,880)	$ (4,784,404)	$ -	$ (6,044,380)

	Mt. Angel Telephone Company	DirectLink of Oregon, Inc.	Canby Telephone Association	Eliminations	Consolidated
Cash Flows from Financing Activities:					
Payments to estates, net	-	-	(35,947)	-	(35,947)
Net Cash Used by Financing Activities	-	-	(35,947)	-	(35,947)
Net Decrease in Cash and Cash Equivalents	(771,901)	(351,845)	(1,430,360)	-	(2,554,106)
Cash and Cash Equivalents, beginning	771,901	470,174	2,661,820	-	3,903,895
Cash and Cash Equivalents, ending	$ -	$ 118,329	$ 1,231,460	$ -	$ 1,349,789
Non-Cash Investing Activity:					
Acquisition of Mt. Angel through sale of assets	$ 2,775,000	$ -	$ (2,775,000)	$ -	$ -
Cash Paid During the Year for Interest	$ 30,000	$ -	$ -	$ (30,000)	$ -
Cash Paid During the Year for Taxes	$ -	$ 24,404	$ 16,493	$ -	$ 40,897